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FILED

No. 88-1409

In The

Supreme Court of the United States

October Term, 1988

FRANCHISE TAX BOARD OF THE STATE OF CALIFORNIA; LEONARD WILSON, Individually and as District Manager, Chicago Office of the Franchise Tax Board of the State of California; and R. M. EARMAN, Individually and as Auditor, Chicago Office of the Franchise Tax Board of the State of California,

Petitioners,

v.

IMPERIAL CHEMICAL INDUSTRIES PLC,

Respondent.

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SEVENTH CIRCUIT

RESPONDENT'S BRIEF IN OPPOSITION

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COUNTER STATEMENT OF QUESTIONS PRESENTED

1. Whether a foreign corporation that is denied access to State courts to present claims of independent injury arising from the acts of a State revenue authority also should be denied standing to present its claims of independent injury in federal court.

2. Whether, a foreign corporation that has standing in federal court to present claims of independent injury arising from the acts of a State revenue authority is nonetheless barred by the Tax Injunction Act (28 U.S.C. § 1341) in the absence of a State remedy.

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RESPONDENT'S BRIEF IN OPPOSITION

Respondent Imperial Chemical Industries PLC ("Imperial")[1] opposes the Petition for a writ of certiorari to review the judgment of the United States Court of Appeals for the Seventh Circuit remanding this case and the related case of *Franchise Tax Board v. Alcan Aluminium Ltd* to the United States District Court for the Northern District of Illinois for further proceedings.

INTRODUCTION

The district court's dismissal of the two related cases below and the court of appeals reversal and remand were made on the pleadings without consideration of the extensive factual records that had been stipulated. The court of appeals

[1]The names of corporations affiliated with Imperial that are not wholly-owned subsidiaries are listed in Appendix 1.

decision for which review by this Court is sought is not, therefore, final. An interlocutory decision should not be reviewed where, as here, it does not pose a serious and unsettled question of law the resolution of which is fundamental to further proceedings ordered by the court of appeals. It is only after such further proceedings are held that a decision on the merits based on a complete record will be rendered. Until that time, the Petition is premature and should be denied.

COUNTER STATEMENT OF THE CASE

Imperial filed a complaint on 17 October 1984 in the United States District Court for the Northern District of Illinois against the Petitioners, the Franchise Tax Board of the State of California and the manager and auditor of their Chicago office ("Board"), seeking declaratory and injunctive relief in respect of California income tax assessments.[2] A complaint seeking similar relief had been filed in the same court on 10 August 1984 by Alcan Aluminium Ltd ("Alcan") alleging different facts than the Imperial complaint.[3] The Board filed separate motions to dismiss each complaint on the ground that neither plaintiff had standing to maintain its action in federal court.

On 10 January 1985 the district court (Judge Marshall) ruled that Alcan's allegations, if proven, would confer standing and ordered the Board to file an answer.[4] On 29 January 1985 the Board withdrew their motion to dismiss Imperial. On the same date the district court entered a "finding of relatedness" between Imperial's and Alcan's cases and assigned both cases to Judge Marshall. No order of consolidation pursuant to F.R.Civ.P. 42 was ever issued. The Board thereafter filed a separate answer to each complaint. Each case was reassigned on 19 June 1985 to Judge Williams.

[2] *Imperial Chemical Industries PLC v. Franchise Tax Board*, No. 84-C-8906.

[3] *Alcan Aluminium Ltd v. Franchise Tax Board*, No. 84-C-6932.

[4] Memorandum opinion, Appendix 2.

Separate agreements were reached between the Board and each plaintiff that each case would be submitted on a fully stipulated record without oral testimony. The joint stipulation in Imperial's case was filed 2 December 1985.[5] On 3 February 1986 Imperial filed a motion for summary judgment together with the summary statement of facts required by district court rule 12(e) to be filed by each party to a civil action. Imperial's summary statement requested the district court to make findings of fact from the record. The Board responded on 28 March 1986 by filing a cross motion for summary judgment specifically requesting reconsideration of the prior ruling on standing and making an additional claim that the action was barred by the Tax Injunction Act, 28 U.S.C. § 1341.[6] The Board did not request findings of fact. Similar motions were filed in the related (*Alcan*) case.

On 30 July 1987, the district court reversed the prior order respecting standing and granted the Board's motion in each case to dismiss for lack of standing. No ruling was made in respect of the Tax Injunction Act. The district court's opinion makes no findings of fact; makes no reference to the record; and apparently bases the decision solely on the pleadings.[7]

Imperial and Alcan each filed separate appeals to the United States Court of Appeals for the Seventh Circuit. Imperial's appeal maintained that its complaint alleged independent injuries to Imperial and that the district court failed to consider whether facts of record sustained those allegations. The Board argued that because each appellant was

[5] Imperial's stipulation consists of 20 pages of text with approximately 950 pages of exhibits without agreement between the parties as to relevance or materiality of the exhibits. Alcan's stipulation contains 40 pages of text and more than 1,000 pages of exhibits. The facts in *Alcan* are materially different from those adduced in *Imperial*.

[6] The district court declined to rule on Imperial's objection ("Plaintiff's Reply to Defendant's Cross Motion" filed 3/28/86) that this motion was untimely under F.R.Civ.P. 60(b).

[7] Petition, pp. A-25—A-27. In granting the Board's motion for reconsideration of the prior standing ruling, the district court made no reference to the stipulated records. The memorandum opinion deals entirely with the right of stockholders to maintain actions for injury to their corporation.

merely a shareholder of a taxpayer corporation, it had no standing *in limine* to raise objections to California taxes in either federal or State courts.

The court of appeals found that both appellants had "alleged injuries resulting from California's franchise tax that are sufficiently direct and independent of the injuries to their subsidiaries to confer standing."[8] Absent findings of fact by the district court, each case was remanded for further proceedings, presumably to make findings of fact from the record and to make conclusions of law.[9] The Board thereupon filed their Petition for certiorari with this Court.

REASONS WHY THE PETITION SHOULD BE DENIED.

1. *Review of the interlocutory decision below is not warranted.* The Petition seeks review of an interlocutory decision by the court of appeals. No final decision on the merits has been made nor can be made until the district court conducts further proceedings as ordered by the court of appeals. Absent extraordinary circumstances, a writ of certiorari should not issue until a final decision on the merits is rendered on a complete factual record.[10] Where a case is remanded by a court of appeals for further proceedings, certiorari is usually denied because the case "is not yet ripe for review by this Court."[11]

Exceptions to this principle of certiorari jurisdiction over interlocutory orders are few. Review of an interlocutory order should only occur where a "serious and unsettled" question of law is presented.[12] Even where such a question

[8]Petition A-20.

[9]It is not unusual in tax cases to proceed to judgment on partially or fully stipulated records. See TAX COURT RULES 122 and 90(a). A fully stipulated record should not relieve a trial court from examining evidence adduced, hearing argument, and deciding what is relevant and material as well as what inferences are to be drawn from facts of record to support findings of fact and conclusions of law.

[10]*Hamilton-Brown Shoe Co. v. Wolf Bros. & Co.*, 240 U.S. 251, 258 (1916).

[11]*Brotherhood of Locomotive Firemen & Enginemen v. Bangor & Aroostook R.R.*, 389 U.S. 327, 328 (1967).

[12]*Nixon v. Fitzgerald*, 457 U.S. 731, 743 (1982).

of law is presented, review is generally denied unless resolution of the question is "fundamental to the further conduct of the case."[13]

Analysis of those cases that have granted certiorari for interlocutory orders demonstrates the narrow limits this Court has placed on such review. Certiorari has been granted to review a court of appeals remand involving scope and application of the Constitution's "just compensation" requirement to leasehold property (then an issue of first impression) resolution of which was necessary to delineate the scope of additional proceedings.[14] Certiorari was similarly granted to review and affirm a court of appeals remand for hearing on the merits in order that this Court could establish guidelines to distinguish between claims against officers of the United States for unauthorized actions and claims against the United States itself.[15] Further clarification of the distinction between a tort claim against a public official and a claim that impleaded the sovereign was also the reason for granting certiorari to review a court of appeals remand for trial.[16]

These three cases demonstrate that certiorari under 28 U.S.C. § 1254(1) to review an interlocutory order is granted only when there is some compelling principle of law that needs to be clarified *without regard to findings of fact.* This principle underlay grant of the writ in *Gwaltney of Smithfield v. Chesapeake Bay Foundation.*[17] A court of appeals, contrary to two other courts of appeals, had read the Clean Water Act[18] to permit a civil suit to continue where the pollution had ceased prior to filing the suit. There was no *fact* issue respecting cessation.

[13]*United States v. General Motors Corp.*, 323 U.S. 373, 377 (1945).

[14]*Id.*, n. 13 *supra*.

[15]*Land v. Dollar*, 330 U.S. 731 (1947). This Court noted that "this is the type of case where the question of jurisdiction is dependent on the decision of the merits." *Id.* at p. 735.

[16]*Larson v. Domestic & Foreign Commerce Corp.*, 337 U.S. 682 (1949). Because this Court found that the cause of action was against the United States itself, and this determination did not depend on the facts alleged, the complaint was ordered dismissed.

[17]484 U.S. —, 108 S. Ct. 376 (1987).

[18]33 U.S.C. § 1365(a).

In light of these principles, the court of appeals decision that Imperial's allegations of independent injury are sufficient to confer standing does not pose a serious and unsettled question of law. This Court should not be imposed upon to make original findings of fact from an extensive record as implicitly required by the Petition.[19]

(a) *No conflict of law exists among the circuits.* The Board argue that the decision of the Seventh Circuit in this case conflicts with decisions in the Ninth and Second Circuits.[20] The different results, however, appear to arise from differences in allegations of facts, not differences in legal principles. This Court should not be petitioned to resolve differences in result where there are virtually no facts of record in any of the cases cited to demonstrate the putative conflict. Certiorari was denied by this Court in all three precedents cited by the Petition none of which had complete factual records.[21]

Each of these precedents involved standing of a foreign parent-shareholder to contest a worldwide, combined income apportionment and tax assessment. In each case, the court found that the parent-shareholder had no interest in the subject matter other than as a shareholder of a domestic taxpayer. Each court believed this was insufficient to give the parent separate standing to contest the taxes assessed. Each case was decided on a motion to dismiss by reference to pleadings or affidavits without evidentiary hearing or

[19]This Court granted certiorari and then dismissed "for want of a substantial federal question" in *Chicago Bridge & Iron Co. v. Caterpillar Tractor Co.*, 454 U.S. 102 (1981), *dismissed* 463 U.S. 1220 (1983), apparently because the case was not in an appropriate posture to give adequate consideration to the significant issues arising from Illinois' application of worldwide combined income apportionment for taxation. This Court later heard and decided *Container Corp. v. Franchise Tax Board*, 463 U.S. 159 (1983), when similar issues were presented but on a complete record with findings of fact, appellate review, and the proper parties.

[20]Petition, pp. 7-8.

[21]*EMI Ltd. v. Bennett*, 738 F.2d 994 (9th Cir.), *cert. denied*, 469 U.S. 1073 (1984); *Alcan Aluminum Lim.*, 742 F.2d 1430 (2d Cir. 1983), *affirming without opinion* 558 F. Supp. 624 (S.D.N.Y.), *cert. denied*, 464 U.S. 1041 (1984); *Shell Petroleum, N.V. v. Graves*, 709 F.2d 593 (9th Cir. 1983), *cert. denied sub nom., Shell Petroleum N.V. v. Franchetti*, 464 U.S. 1012 (1983).

stipulation of facts. The limited facts recited in the three cited decisions compared with the allegations, to say nothing of the extensive record, in the instant case demonstrate why certiorari is no more appropriate in the instant case than it was in these precedents.

The first of the precedents to be decided was *Shell*, upon the authority of which the other two relied. The foreign parent, who together with its domestic subsidiary faced a large, proposed, worldwide, combined income assessment based on failure to disclose information that only the foreign parent could provide, sought a declaratory judgment. The gravamen of the complaint was an alleged treaty violation.[22] Shell's complaint was dismissed for both lack of ripeness and lack of standing.[23] As to standing, the court held that the treaty did not give a foreign corporation any rights that a domestic corporation would not have and that "[the] method of taxation that [Shell] seeks to enjoin does not injure [Shell] directly or independently . . . ."[24] The court in *Shell* clearly viewed the complaint as a challenge to the method of income apportionment in the abstract. The court did not consider in the *Shell* opinion the cost of compliance; actual or threatened double taxation; the effect the method of tax might have on the parent company's foreign commerce with the United States; nor the federal government's position on the issue presented.

Whether the plaintiff in *Shell* alleged an independent injury is not entirely clear. The significant point is that both the district court and the court of appeals believed that the parent corporation did not allege an independent injury and assumed that it did not sustain an independent injury.[25]

[22]Treaty of Friendship, Commerce and Navigation, 27 March 1956, United States—Netherlands, 8 U.S.T. 2043, T.I.A.S. No. 3942.

[23]The Seventh Circuit Court of Appeals has similarly dismissed a foreign parent-shareholder suit for lack of ripeness, while suggesting there *might* be standing *if* the parent could prove independent injury. *Alcan Aluminium Ltd. v. Oregon Dept. of Rev.*, 724 F.2d 1294 (7th Cir. 1984).

[24]709 F.2d 593, 595.

[25]*Ibid.* The district court (but not the court of appeals) referred to Shell's contentions that "the California apportionment method . . . is repugnant to [the Constitution] . . . violates [the treaty] . . . and violates 'general principles of international law'." *Shell Petroleum, N.V. v. Graves*, 570 F. Supp. 58, 60 (N.D. Cal. 1983). The district court believed these general allegations directed to the method of income apportionment fell short of alleging independent injury to the parent company.

The second case is *EMI.* EMI's U.S.A. subsidiary, Capitol, had filed an action in federal court contesting a worldwide, combined income apportionment and informational demands that could only be met by Capitol's foreign parent, EMI. Capitol's action was dismissed because of the Tax Injunction Act.[26] EMI's separate action was dismissed for lack of standing because the court found EMI had no interest other than as a shareholder. The court of appeals stated, "[t]his case is controlled by *[Shell Petroleum v.] Graves.* The facts in *Graves* are nearly identical to those presented here."[27] EMI's complaint, similarly to Shell's, relied on a treaty.[28] EMI, in addition, alleged that United Kingdom law prohibited the disclosure of some information demanded by the Board. The court, however, found EMI's essential complaint to be diminution of value of its United States subsidiary and legality of the "unitary" tax method itself.[29] The court held neither of these grounds sufficient to confer standing on a shareholder. As in *Shell,* the *EMI* decision mentioned no facts concerning double taxation and none about costs of compliance nor burdens on foreign commerce. The federal government did not file a position in the case. The *EMI* case is far removed from the specific facts alleged by Imperial.

The *Alcan* case also did not consider a full record. The opinion expressly follows *Shell* in finding there was no standing for a foreign parent to challenge the unitary tax method. The court stated that the facts were "strikingly similar" to *Shell* and the district court decision in *EMI.*[30] The court recognized, however, ". . . that the fact that [Alcan's] subsidiary has a remedy and standing is no reason for this Court to deny standing to [Alcan]. This would be true if [Alcan] had a valid independent basis for standing."[31] But

[26]28 U.S.C. § 1341.

[27]738 F.2d 994.

[28]United States—United Kingdom Income Tax Convention of 1946, 60 STAT. 1377-97 (26 June 1946).

[29]738 F.2d 994, 996-997. Worldwide, combined income apportionment for taxation is generally called "unitary" taxation.

[30]558 F. Supp. 624, 628.

[31]558 F. Supp. 624, 627.

the *Alcan* court rested the decision on the same ground as did the courts in *Shell* and *EMI,* that diminution in value of the parent's domestic subsidiary would not suffice to establish an independent cause of action for a stockholder. As in the other two cases, there was no consideration of double taxation; no consideration of compliance cost; no consideration of foreign commerce burden; and no consideration of the federal government's position.

The fact that a subsidiary corporation has its own cause of action should not deprive its shareholder of a separate cause of action simply because both causes arise from related circumstances. The shareholder must, of course, allege and prove its separate injury and prove that the relief sought will benefit it separately. That is the only legal principle enunciated by the decision of the [Seventh Circuit] court below. The general proposition of law upon which the decisions in *Shell, EMI,* and *Alcan* rest is not disputed: A shareholder cannot maintain an action for an injury solely to a corporation in which it is an investor in the Seventh Circuit anymore than it can in the Ninth or Second Circuits. The difference between the instant case and *Shell, EMI,* and *Alcan* is clearly demonstrated by contrasting the *direct* injuries alleged by Imperial with the *indirect* injuries referred to by the courts in the three cited cases. The direct injuries complained of by Imperial are: (1) The burden imposed by the cost and difficulty of compliance, which *must be borne solely by Imperial;* and (2) the burden of double taxation, which *is borne solely by Imperial.* The United States Government filed as *amicus curiae* in the district court in support of Imperial's claims of injury by reason of California's unitary method. Numerous foreign governments[32] also filed appearances to object to application of California's unitary method to foreign nationals.

If a conflict exists between *Shell, EMI,* or *Alcan* and the decision of the court below in this case, it is a difference in

[32]Australia, Canada, Japan, Switzerland, United Kingdom, and The Member States of the European Economic Community (Belgium, Denmark, France, Federal Republic of Germany, Greece, Ireland, Italy, Luxembourg, Netherlands, Portugal, Spain, and United Kingdom).

perception only of facts alleged, not principles of law applicable to facts established in a court of original jurisdiction. The court of appeals, below, acknowledged a possible conflict when they stated, "Insofar as the Ninth Circuit's decisions in *Shell Petroleum, N.V.* and *EMI Ltd., may conflict* with our holding, we are not persuaded to follow them"[33] [Emphasis added]. Resolution by this Court of any arguable conflict is entirely premature until a conflict clearly appears in the decisions of the lower courts. It cannot develop until the full record has been examined and analyzed by the lower courts. The uncertain nature of such a conflict is not one of such importance to the administration of federal law that it need be resolved by this Court at this time. No legal or factual argument available to the Board will be foreclosed by the district court's consideration of Imperial's claims on the facts and the law. If the facts do not support Imperial's position, the standing issue is moot. But if the facts demonstrate there *is injury* to Imperial's commerce with the United States, the court of appeals decision below holds there is standing. This is the only legal principle actually developed at this time and it does not appear to conflict with any enunciated in other circuits.[34]

(b) *The Tax Injunction Act does not bar Respondent's action.* The Tax Injunction Act, 28 U.S.C. § 1341, is not an issue. The Petition cites only that Act under "Statutory Provisions Involved" and devotes fully one quarter of its argument to the philosophy and rationale of the Act. But the complete rebuttal to that argument is stated in the Petition itself. In castigating the court of appeals for their suggestion that California could avoid intrusive federal litigation by providing a foreign corporation with a State remedy, the Board expostulates: "In other words, as the sole stockholders of their respective subsidiaries, both of the parent companies effectively *have* state remedies to pursue."[35]

[33]Petition, A-1, n., A-17, n. 12. See also the court's discussion of *Shell, EMI,* and *Alcan* at A-12, A-13, and A-14.

[34]*See,* discussion of standing principles in *The Presbyterian Church (U.S.A.) v. United States,* ___ F.2d ___, 89 C.D.O.S. 1849, 1850-51 (9th Cir. No. 86-2860, 3/15/89).

[35]Petition, p. 22.

It is undisputed that Imperial cannot contest its subsidiary's taxes in the California courts nor, under the Board's view, is Imperial permitted access to California courts to present claims concerning direct injuries.[36] Not only is there no "plain, speedy, and effective remedy" in California courts, there is no remedy at all.[37] This very point, with an admonition similar to that from the Seventh Circuit, was also made by the Ninth Circuit seven years ago.[38]

The court of appeals, below, completely answered the Board's "heads we win, tails you lose" jurisdictional posture vis-a-vis the Tax Injunction Act when they ruled: "We hold that comity and federalism, weighty as these concerns are where federal courts pass on the constitutionality of state tax legislation, cannot justify withholding federal jurisdiction from a party with no cause of action in state court to redress its own independent injury."[39] Respondent, Imperial, cannot add anything to the clarity and logic of that statement.

(c) *There is no interference with further proceedings.* The court of appeals did not and this Court does not have the benefit of a district court's findings of fact or conclusions of law from a voluminous record. Both the district court's judgment and the court of appeals reversal were made on the

[36]Imperial does not maintain a presence in California. This fact distinguishes the instant case from *Barclay's Bank Int. Ltd v. Franchise Tax Board,* No. 32059, Cal. Super. Ct., Sacramento Co., 20 Aug. 1987, now on appeal to the California Court of Appeal. In that case, the foreign parent as well as its United States subsidiary did business in California and thus had standing as a "taxpayer" in California courts. *Barclay's* is the first case in which a foreign parent, itself, has been able to contest the unitary tax method. After careful consideration of an extensive record the trial court held that the method violated the Commerce Clause of the Constitution insofar as the foreign parent was concerned. The legal issues in *Barclay's* are essentially the same as the legal issues on the merits in the instant case.

[37]See Petition, p. 21, n. 11.

[38]*Capitol Industries—EMI, Inc. v. Bennett,* 681 F.2d 1107, 1119 n. 32 (9th Cir.), *cert. denied,* 459 U.S. 1087 (1982).

[39]Petition, A-19. This Court has similarly held that the Federal Anti-Injunction Act, 26 U.S.C. § 7421(a), which imposes an even more stringent bar than 28 U.S.C. § 1341, does not bar a suit against the federal government when "Congress has not provided the plaintiff with an alternative legal way to challenge the validity of a tax." *South Carolina v. Regan,* 465 U.S. 367, 373 (1984).

pleadings without considering whether facts of record actually supported allegations of the complaint. The decision of the court of appeals, therefore, seeks to put the case in an appropriate posture for judicial consideration on its merits. The Board are not irreparably prejudiced by the decision. They will have the opportunity to make their case in district court and, if aggrieved by that decision, to appeal findings of fact and conclusions of law. This controversy cannot now be resolved other than by a comprehensive review of the record and a determination whether, on that record, Imperial has proven independent injuries. It is only after such determination that the courts should consider whether those injuries impair constitutionally protected rights.

2. *Review of the merits argued by the Petition is premature and inappropriate.* The instant case has never progressed beyond consideration of preliminary issues by the lower courts. The case is not, therefore, appropriately developed for this Court to make the necessary judgments on the important questions of foreign relations, foreign commerce, and federal prerogatives expressly left undecided in *Container Corp.*[40] Despite this lack of development, the Board now argue that the *facts* contained in the district court record rebut the judgment of the court of appeals.[41] While Imperial deems the Board's argument entirely inappropriate for the instant case in its present posture, the errors presented by that argument must be noted, at least briefly.

The Board present the merits of their case by the rhetorical device of restating the opinion below into form of a syllogism, which the Board then complain incorporates an "incomplete major premise" and a "faulty minor premise" to reach an "invalid conclusion."[42] In order to make this

[40]463 U.S. 159, 189, n. 26 (1983).

[41]The Petition makes no less than ten separate references to the stipulations in the district court cases, despite the fact that neither the district court nor the court of appeals made findings of fact or conclusions of law. While the Petition refers (p. 3, n. 2) to the "comprehensive factual record," the Board found it necessary to dispute both facts and inferences to be drawn from those facts in their response to Imperial's summary statement of facts. See Appendix 3.

[42]Petition, pp. 12-13.

argument, the Board assume facts that are not of record and ignore others that are. The points the Board are disputing are not based on findings of fact made by the court below, they are naked assertions that must be resolved by a trial court. If the Board now wish to offer evidence to complete the "incomplete major premise" (the Board's own premise, in reality), the proper forum is district court.

The Board's "minor premise" which they claim to be "faulty" is derived by quoting the court of appeals out of context.[43] The Board admit that if Imperial only *sold* into California through unrelated companies, Imperial would have no *California taxable income* from those sales. By reason of having a subsidiary with payroll and property in California, however, *all of Imperial's sales income everywhere* becomes the apportionment base for taxation by California.[44] The Board should not be heard to argue in this Court the merits of their case for the first time. The Board chose to renew their motion for judgment on the pleadings after having spent over one year negotiating a fully stipulated record with Imperial. Imperial was, indeed, criticized by the Board for even submitting requested findings of fact to the district court.[45] Despite their vigorous opposition to consideration by the district court of facts of record, the Board now select extracts from that voluminous record and assert that these extracts demonstrate the error of the court of appeals decision. But that decision makes clear that if facts of record are not found to sustain Imperial's allegations, there would be no independent injury and, concomitantly, no standing to complain. The court of appeals expressly did not decide whether, assuming independent injury were found, constitutional rights of Imperial had been infringed: "Evaluation of the constitutional significance of this threat in the particular circumstances presented by California's unitary tax must await the district court's assessment of the merits of this

[43]Petition, pp.12-13, n-7.

[44]This would be true even if Imperial *and* the subsidiary had *no* sales in California. CALIFORNIA REV. & TAX. Code §§ 25102, 25121, and 25128.

[45]Defendant's Response to Plaintiff's Summary Statement of Stipulated Facts, Appendix 3 pp. 3-1, 3-2.

appeal. We decide only that the potential for constitutionally significant offense is sufficient to create standing."[46]

The core of the Board's factual argument is their repeated assertion that Imperial is not directly affected by California's tax system or the Board's actions.[47] Having thus declared that Imperial is not a "taxpayer," they proclaim that Imperial has no standing in California courts and no standing in federal courts because Imperial's only interest is that of a shareholder/investor. This argument is wrong for two reasons. First, the burdens imposed on Imperial by the Board are the burdens imposed on a taxpayer: to maintain records, calculate tax, and provide for its payment. Imperial is in substance a taxpayer. The Board in practice—except when it comes to standing—treat *all* corporations within a unitary group as one taxpayer.

The Board's definition of who is a "taxpayer" for procedural and standing purposes directly conflicts with the definition employed when applying the unitary tax method. A like attempt by the Board to misuse their protean definition of "taxpayer" was recently rebuffed by the California State Board of Equalization ("CSBE") who observed: "It is apparent that in all UDITPA provisions dealing with formula apportionment except 25135, the FTB interprets the term taxpayer to mean all of the corporations within the combined unitary group."[48] The Board are similarly trying to define "taxpayer" so as to prevent Imperial's case from being heard *in any court.*

The second error in the Board's logic appears when they declare that Imperial is *merely* a stockholder having only a

[46]Petition A-16, n. 10.

[47]Petition, pp. 10, 11, 13, 21.

[48]*Appeal of Finnigan Corp.*, 88-SBE-022 pp. 159, 162, decided 25 Aug. 1988, Appendix 4, p. 4-4. CALIFORNIA REV. & TAX. CODE § 25135 requires sales of tangible personal property to be treated as California sales for tax purposes if the property is shipped from California and "the taxpayer is not taxable in the state of the purchaser." In *Finnigan*, the Board attempted to apply this provision to out of California sales of a subsidiary corporation by arguing that the subsidiary was *not* a "taxpayer" in those States in which the parent *was* a taxpayer. The CSBE held that if the parent was a taxpayer in the other State, then the subsidiary was necessarily a taxpayer in the other State as well.

remote interest in the business of its subsidiary, even though, in the Board's own words, "Alcan and Imperial, which have absolute control over their subsidiaries, obviously are in a position to ensure that these remedies are pursued with vigor."[49] It is these elements of control and direct interest in the business of the subsidiary that are the very foundation of California's unitary tax method. The Board wish to have it both ways: Imperial is a taxpayer for purposes of apportioning taxable income; Imperial is not a taxpayer for purposes of contesting that apportionment.

Imperial's action seeks adjudication of its claims based on the law as applied to proven facts. Analysis of those facts will show that Imperial incurs substantial and unreasonable burdens on its commerce with the United States by reason of the Board's administration of California's unitary tax method; that these burdens affect and interfere with prerogatives of the federal government; that the federal government deems California's unitary tax method an interference with foreign commerce and foreign relations of the United States; and that foreign governments have protested California's unitary tax method and have proposed retaliatory measures against United States businesses. The adjudication sought should be made initially by the district court and reviewed by the court of appeals, if necessary. It is only then, if at all, that the instant case will be in a form suitable for presentation to this Court.

[49]Petition, p. 22.

CONCLUSION

For the reasons stated, review by this Court of the decision of the Seventh Circuit Court of Appeals remanding Imperial's case to the United States District Court for the Northern District of Illinois for further proceedings is inappropriate. The Petition for Certiorari should be denied.

Respectfully Submitted,

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APPENDIX 1

CORPORATIONS AFFILIATED WITH IMPERIAL CHEMICAL INDUSTRIES PLC[1] THAT ARE NOT WHOLLY OWNED SUBSIDIARIES.

Group I—Subsidiaries and Affiliates.

ACF & Shirley Ltd; Advanced Systems Consultants Limited; AFL Pty Limited; Aftrade Pty Limited Agchem Pty Ltd; Agtech Developments (N.Z.) Limited; Alchem Inc.; Alchemie Research Centre (Private) Ltd; Ammonia Company of Queensland Pty Limited; Andrews Lees (NZ) Ltd, Atlas de Mexico, S.A. de C.V.; Atlas Taiwan Corporation; Attivalac S.R.L.; Austral-Pacific Fertilizers Limited; Australian Fertilizers Limited; Australian Sun Research Laboratories Pty Limited; Australian Sun Research Labs, Inc.; Avon Manufacturing Co Limited.

Balm Paints (NZ) Limited; Bay Industries Limited; Berger Paints New Zealand Ltd; BJN (FIJI) Ltd; BJN Holdings New Zealand Ltd; BJN Investments Pty Ltd; BPA Industries Pty Ltd; Brasek Participacoes Ltda; British Paints (PNG) Pty Ltd; British Paints NZ Ltd.

Catoleum New Zealand Limited; Catoleum Pty Limited; Chemetics do Brasil Comercio & Industria Ltda; Chemical Company of Malaysia Berhad; Chemical Supplies Limited; Chopcair Ltd; Colourmarket New Zealand Ltd; Compagnie Europeenne des Preintures Julien SA; Companhia de Explosivos Valparaiba; Consolidated Fertilizers Ltd; Coopers Animal Health Australia Limited; Coopers Animal Health NZ Limited; CXA Limited.

Dendrite Australia Pty Ltd; Dendrite Corp (NZ) Ltd; Denkemix Inc.; Dulux Holdings Limited; Dulux Papua New Guinea Pty Ltd; Dyechem Finance Limited; Dyes and Chemicals Limited.

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[1] Imperial Chemical Industries PLC is a United Kingdom capital stock company whose shares are traded on the London Stock Exchange. Imperial's shares are also listed on the New Stock Exchange in the form of American Depositary Receipts.

Eastern Nitrogen Limited; Ebonex Technologies Inc.; Explo Industrias Quimicas e Explosivos S.A.; Explonor Inc.; Explosifs Saguenay Inc.

Flex Products Inc.

G F Real Estate Pty Limited; General Fertilisers Limited; George Shirleys (NSW) Pty Ltd; Guthrie Bowron & Co Ltd.

Hydroline P/L.

I.C. Insurance (Australia) Limited; I.C. Insurance Advisory Services Propriety Limited; I.C.I. France S.A.; I.C.I. Paints (Malaysia) SDN BHD; ICI Agrochemicals (Malaysia) SDN BHD; ICI Alfloc Limited; ICI Asiatic (Agriculture) Company Limited; ICI Asiatic Chemicals Co Ltd; ICI Australia Engineering Proprietary Ltd; ICI Australia Finance Limited; ICI Australia Investments Pty Ltd; ICI Australia Limited; ICI Australia Nominees Pty Ltd; ICI Australia Operations Pty Ltd; ICI Australia Petrochemicals Limited; ICI Australia Services Pty Ltd; ICI Bangladesh Manufacturers Limited; ICI Biocol Limited; ICI C&P France S.A.; ICI Chile S.A.: ICI Diminicana S.A.; ICI Dulux Papua New Guinea Pty Limited; ICI Explosives (QLD) Pty; ICI Explosives South East Asia PTE Ltd; ICI Fertilizers (Malaysia) SDN Berhad; ICI Figi Limited; ICI Industrial Chemicals (Malaysia) SDN BHD; ICI Instruments Pty Ltd; ICI Kern; ICI New Guinea Plastics Pty Ltd; ICI New Zealand Limited; ICI Paints (Thailand) Limited;

ICI Pakistan Limited: ICI-Pharma Limited; ICI Synchem Limited; ICI-Woobang Co., Ltd.; ICIBRA Participacões e Comercio Ltda; IDAC (Italia) S.R.L.; IEL Limited; Imperial Chemical Industries de Centro America, S.A.; Impkemix Americas Holdings Inc.; Impkemix Holdings South East Asia PTE Ltd; Impkemix HongKong Limited; Impkemix Investments (NZ) Ltd; Incitec Investments Ltd; Incitec Ltd; Industrial Containers Ltd; Initiating Explosives Systems Pty Limited; Interplastic-Werk Aktiengesellschaft.

J Armando Industria e Comercio de Plasticos Ltda.

K C Chemical Industries P/L; Kaohsiung Monomer Co Ltd; Katalco Limited; Kooragang Investments Pty Limited.

Lehard (Trading) Ltd; Lehard Ltd.

Marlborough Bio-Polymers Limited; Max Agriculture SDN BHD; Minzimp Exploration Ltd; MODO Chemetics Engineering Ltda.

Nalco South East Asia Private Limited; Nalfleet, Bull and Roberts Inc.; Nalfloc Limited; Nalfloc Norge; Newcastle Chemical Co. Pty Ltd; Nilcra Ceramics (Europe) Limited; Nilcra Ceramics Inc.; Nilcra Ceramics Pty Ltd; Northland Explosives Inc.; Nuclear Techniques International (M) SDN BHD; Nuwest Explosives Inc.

Olefines Pty Ltd; ORBEA o de Julio S.A.I.C.; ORBEA Argentina Sociedad Anonima.

Pacific Paints Pty Ltd; Papl New Zealand Limited; Phillipine Explosives Corporation; Polycell Products Pty Ltd; Porcupine Powder Company Inc.; Propafilm P/L; PT ICI Farmasi Indonesia; PT ICI Pestisida Indonesia; PT Nalco Perkasa; PT Techmaster Well Services Indonesia.

Retec Limited; Ruane Investments Pty Ltd.

Sai Tubular Services Limited; Sarkem Limited; Seedkem Pty Ltd; Selleys Chemical Co NZ Ltd; Selleys Chemical Co. Pty Ltd; Sentinel S.A.; Silenus Instruments P/L; Silenus Laboratores Pty Limited; Societe Europeenne De Mais SA; Society Malgache des Laques Valentine; Stahl Asia Trading Private Ltd; Stahl Chemical Asia Private Ltd; Stauffer Chem Co (New Zealand) Ltd; Stauffer de Mexico; Strauss 9 De Julie S.A.I.C.

Techmaster Well Services (Malaysia) Sun. Bhd; Techmaster Well Services Austrialia Pty Ltd; Tema Chemicals Ltd; Terra Trading Co Pty Limited; Tingeys Limited; Tribol S.A.

United Pacific Drilling P/L; UPEC Industries Limited.

Valchem Pty Ltd.

Walpamur Ltd; West African Explosives & Chemicals Limited.

Z-Tech Corporation; Z-Tech Pty Limited; Z-Tech Zirconia Pty Ltd; Zest Products Pty Limited.

Group II—Related Companies.

AECI Limited; AFEX Holdings (Proprietary) Limited; Agrocentre Farnham Inc.; Agrocentre St. Hyacinthe Limited; Agrocentre St. Remi Inc.; Agrocentre Vinisol Inc.; Agro Inc.; Albright & Wilson (Australia) Limited; Arabian Polyol Company Limited; Asahi Fluoropolymers Company Limited; Associated Irish Cases Limited; Atic Industries Limited.

Bapco; Barclays de Zoete Wedd Securities (Asia) Ltd; Basic Management Inc.; Belasis Hall Technology Park Limited; Belmont Farm Supply; Besguard Limited; Bessemer Road Management Co. Ltd; Blair International Insurance Ltd; Bluewater Agromart Limited; Boripol; Boyes Explosives (Eastern) Limited; Boyes Explosives Limited; Brussels Agromart Ltd; BXL Bulk Explosives Limited.

Cafchem Limited; Canadian Fracmaster Limited; Canamex, S.A. de C.V.; Canso Chemicals Ltd; Cardinal Farm Supply Limited; C.F. Braun Inc.; CFX Computer Solutions; Chemetics Lavalin Inc.; Chemical Industries (Colombo) Limited; Colombiana de Colina Ltda; Colour Printers Specialist (Singapore) Pte Ltd; Coopers Animal Health (Holdings) Limited; Cornwall Chemicals Limited; Coulter Farm Services, Inc.; Covenant Industries Limited; Covilink Limited; Cuprex Joint Venture.

East-Chem Inc.; Electroclor S.A.I.C. (Abbreviation); Electroquimica Argentina S.A.I.C.; Ellix & Everard PLC; Emirates Explosives (Private) Limited; Enterprise Oil PLC; European Vinyls Corporation Holdings BV.

Fingal Farm Supply Limited; Finlayson House Private Limited; Finicisa Fibras Sinteticas Sociedad SARL.

GBC Scientific Instruments P/L; Garst Research Farms Inc.; Gas Gathering Pipelines (North Sea) Limited; Global

Holonetics Corporation; Grand Falls Agromart Ltd; Grand River Farm Supply Limited.

Hartland Agromart Ltd; Harvex Agromart Inc.; Hiflon Plasticos Avancados Ltda; Hildener Aktienbaugesellschaft; Hispanic Industrial S.L.; Hoegy S Farm Supply Limited.

ICI-Farma S.A.; ICI-Zelita S.A.; IDAC Belgium; I.D. Chemicals Limited; IIE Limited; Innosyl Inc.; Intelligent Systems International Limited; Intermedios Organicos S.A.; Irish Fertilizer Industries Limited.

Kasei-Fiberite Co. Ltd; Kromo S.A. de C.V.

Laurence James Electrical Ltd; L'Environnement Eaglebrook (Quebec) Ltee; Les Engrais Lanaudiere Inc.; Les Explosifs Chretien Ltee; Libra International Insurance Limited; Limpact Industries.

Malpeque Fertilizers Ltd; Maple Farm Supply Limited; Marlow Foods; Max Underhill S Farm Supply Limited; Montrose Chemical Corporation of California; MTM PLC; Munro Fertilizers Ltd.

New Zealand Pharmaceuticals Limited; Nippon Polyurethane Industry Co Ltd; Nurel S.A.

Oakwood Agromart Ltd; Oxford Agropro Ltd.

Phillips-Imperial Petroleum Limited; Phytotech Societe Anonyme; Pigment Manufacturers of Australia Ltd; P.T. ICI Paints Indonesia.

Quimicas Lucava SA; Quimica Stahl Polyvinyl CA.

Recuperados Quimicos LDA; Rock Environmental Limited; Rubicon Inc.

Sabag Inc.; Scotland Agromart Limited; Selbat S.A.R.L.; Serco Lubricantes Metalicos SA; SES Iberica SA; Setterington S Fertilizer Service Limited; Sidlaw Grain Company Ltd; Sirotherm Inc.; Societe Anonyme Negocitas; Societe du Polyethelene de Fos; Societe Guineenne de Produits Explosifs et

Chimiques (SOPEC); Sprucedale Agromart Limited; Swaziland Agricultural Suppliers (Pty) Ltd.

Teijin Agrochemicals Ltd; Tioxide Group PLC; Tricil Limited; Tri-County Agromart Ltd.

Unicorn Plant Breeders Limited; Unisigma G.I.E. de Recherche et Selection.

Viniclor S A; Vinidex Tubemakers Pty Ltd.

Watford Grain and Feed; West Isle Farm Supply; Weston Hyde Products Limited.

128639 Canada Inc.

APPENDIX 2

**IN THE UNITED STATES DISTRICT COURT
FOR THE NORTHERN DISTRICT OF ILLINOIS
EASTERN DIVISION**

ALCAN ALUMINIUM LIMITED,
Plaintiff,
FRANCHISE TAX BOARD OF THE STATE OF CALIFORNIA, etc., *et al.*,
Defendants.
No. 84 C 6932

MEMORANDUM OPINION

Prentice H. Marshall, District Judge

Plaintiff Alcan Aluminium Ltd. alleges that the State of California's worldwide unitary taxation program, administered by defendants, the Franchise Tax Board of the State of California (the Board) and certain representatives of the Board, violates the Foreign Commerce Clause of the United States Constitution. Worldwide unitary taxation imposes a tax obligation based upon the income of all companies the Board determines are engaged in a single or unitary enterprise. Defendants have moved to dismiss on the grounds of collateral estoppel, lack of standing, and abstention.

Plaintiff, a Canadian corporation, owns approximately one hundred subsidiaries outside of the United States. Neither plaintiff nor any of its foreign subsidiaries conducts business in the United States. Plaintiff also owns Alcan Aluminum Corp. (Alcancorp), a New York corporation with its principal place of business in Cleveland, Ohio. Alcancorp conducts business in California and is subject to the unitary business income tax.

The Board maintains an office in Chicago, and the two individual defendants operate out of the Board's Chicago

office. For the purposes of determining Alcancorp's unitary income, defendants have required plaintiff to provide information relating to the activities of plaintiff's foreign subsidiaries, a requirement which has burdened plaintiff financially. According to the complaint, imposition of the unitary income tax burdens not only Alcancorp, but plaintiff and its foreign subsidiaries as well.

In 1981 plaintiff sued the Board and certain agents of the Board based upon the unitary income tax applied to Alcancorp, in the United States District Court for the Southern District of New York. In that action the court held that plaintiff, as a parent corporation, lacked standing to contest the taxation of Alcancorp, its subsidiary. *Alcan Aluminum Ltd.* v. *Franchise Tax Board of the State of California,* 558 F. Supp. 624 (S.D. N.Y. 1983) *(Alcan I).* The Second Circuit affirmed the decision, *Alcan Aluminum Ltd.* v. *Franchise Tax Board of the State of California,* No. 83-7236 (2d Cir. June 17, 1983), and the Supreme Court denied certiorari, 104 S. Ct. 1457 (1984). Defendants argue that the result in *Alcan I* precludes plaintiff from relitigating the standing issue.

The Supreme Court has held that a judgment holding a particular tax assessment invalid does not collaterally estop collection of the same tax in a later year when there has been intervening authority which supersedes or repudiates the original decision. *Limbach* v. *Hooven & Allison Co.,* 104 S. Ct. 1837 (1984); *Commissioner* v. *Sunnen,* 333 U.S. 591 (1954). Similarly, collateral estoppel should not bar an action challenging imposition of a tax when there is superseding law.

Since *Alcan I,* the court of appeals for this circuit has indicated that a parent corporation has standing to challenge imposition of unitary business income tax on its subsidiary when the parent alleges that the tax burdens its foreign commerce:

> [Parent] has alleged an independent injury as a basis for standing. It claims an unconstitutional burden on its foreign commerce. If [parent's] allegations as to its standing are accepted as true its interests and those of [subsidiary] are not identical. . . . Thus, [subsidiary's] state remedy does not protect appellant fully. As soon as the tax is assessed against [subsidiary], the threat of injury to appellant will be immediate. Nothing in the Tax Injunction Act requires [parent] to wait while [subsidiary] pursues its own remedies under Oregon law for its own injury.

Alcan Aluminium Limited v. *Department of Revenue of the State of Oregon,* 724 F.2d 1294, 1299 (7th Cir. 1983). The court appeals affirmed the dismissal of the action, however, because the tax had not yet been assessed, and, therefore, the case was not ripe.

To apply collateral estoppel as a bar to this action would mean that companies similarly situated to plaintiff could challenge the tax in this circuit, but that plaintiff could not. Collateral estoppel should not be applied to result in such inequality. Further, there is some authority that collateral estoppel should not be applied in a circuit which has adopted a contrary rule of law. *United States* v. *Stauffer Chemical Co.,* 104 S. Ct. 575, 582 (1984) (White, J., concurring opinion).

The Seventh Circuit has recognized that if plaintiff's allegations are true, plaintiff suffers an independent injury from the unitary business tax, and therefore, has standing to contest the constitutionality of the tax. Accordingly, collateral estoppel does not bar this action.

Finally, defendants argue that we should abstain from hearing this action while Alcancorp pursues a refund action in the California courts. Such an action is now pending in the Los Angeles County Superior Court. Defendants assert that the factual determinations made by the California court as to whether plaintiff and Alcancorp are a unitary business may obviate the need to decide the constitutional issues presented in this action. Plaintiff, however, is not a party to the California action. Because plaintiff is not directly taxed, it has no state remedy to exhaust to gain relief from the tax. The state refund action does not fully protect plaintiff's

interests. Plaintiff's only remedy is to contest the constitutionality of the tax. Consequently, abstention to an action in which plaintiff is not a party is inappropriate.

Defendant's motion to dismiss is denied. Defendant to answer the complaint within twenty days of the entry of this order.

ENTER:

/s/ Prentice H. Marshall

Prentice H. Marshall

District Judge

DATED: January 10, 1985

APPENDIX 3

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UNITED STATES DISTRICT COURT
NORTHERN DISTRICT OF ILLINOIS
EASTERN DIVISION

IMPERIAL CHEMICAL INDUSTRIES PLC, *Plaintiff,* v. THE FRANCHISE TAX BOARD OF THE STATE OF CALIFORNIA, operating through its Chicago office, et al., *Defendants.*	No. 84-C-8906 (Judge Williams) DEFENDANTS' RESPONSE TO PLAINTIFF'S SUMMARY STATEMENT OF STIPULATED FACTS

Although the parties to this action have executed a Joint Stipulation of Facts (twice supplemented), plaintiff has deemed it appropriate to prepare on its own a "Summary Statement of Stipulated Facts." In doing so, plaintiff has inappropriately paraphrased a number of stipulated facts

and referred to "facts" that are neither recited in the Joint Stipulation of Facts or otherwise reflected in the record. The particular statements in the Summary in which such liberties have been taken are set forth below with defendants' comments.

This response to the Summary prepared by plaintiff is not to be construed as necessarily conceding the materiality of all of the facts recited in the Summary. In addition, defendants' response is not to be construed as conceding either that plaintiff has recited all material facts contained in the Joint Stipulation or accurately characterized or described the additional facts set forth in the stipulated exhibits. The interpretation and significance of the stipulated facts and exhibits are matters to be covered in legal argument. The following comments therefore relate only to those statements of plaintiff that inappropriately paraphrase the facts as stipulated or refer to alleged facts that do not appear in the record.

STATEMENT NO. 15

"... the Board recomputed business income subject to California tax by applying the three factor apportionment using as the apportionment base the assumed worldwide income of the ICI Group. Stip. ¶ 14."

Comment:

The word "assumed" does not appear in paragraph 14 of the Joint Stipulation. The comparable sentence reads: "... the Board recomputed ICI Am's net income subject to California tax by applying the unitary apportionment method of accounting, using as the apportionment base the worldwide income of the ICI Group." See also Stip., ¶ 30, which states that for purposes of this litigation ICI does not contest the factual correctness of the Board's application of the unitary method.

STATEMENT NO. 19

"In computing the ICI Group's income apportionable to California, the Board began with the consolidated income of

the ICI Group shown in the financial statements contained in ICI's published annual reports, expressed in pounds sterling. Adjustments based on information contained in the published annual reports were made by the Board purporting to eliminate exchange rate gains and losses and the earning of corporations owned 50 percent or less by ICI. Adjustments were also made by the Board to the earnings of ICI purporting to conform the statements to California tax accounting. The Board eliminated nonbusiness income for 1971-1975. For 1976-1980, however, dividends from 50% or less owned subsidiaries of ICI were included as business income. Stip. ¶ 21."

Comment:

(1) The opening phrase of this statement obviously is designed to create the impression that the proposed taxes are being asserted against the ICI Group. The opening phrase of paragraph 21 of the Joint Stipulation actually reads: "In computing the income attributable to ICI Am's California activities..."

(2) ICI twice uses the word "purporting." This word does not appear in the stipulated facts.

STATEMENT NO. 24

"... Americas believes that increased assessments for years after 1981, including 1983, a loss year for Americas, are likely to be proposed by the Board on the same unitary basis as earlier years. Stip. ¶ 29."

Comment:

There is nothing in the record with regard to 1983 being a "loss year" for Americas.

STATEMENT NO. 25

"... Much of the information requested [from Americas] was not readily available from any source and is outside the scope of ICI's accounting records. Stip. ¶¶ 26 and 31; Stip. Ex. 9."

Comment:

This statement is unsupported by the record. Paragraph 26 of the Joint Stipulation merely refers to correspondence between the Board and ICI Am and Paragraph 31, to the annual "T" forms filed by ICI's subsidiaries. Exhibit 9 is a follow-up letter from the Board's auditor to ICI Am.

STATEMENT NO. 26

"... The "T" form is the only standard financial report submitted regularly to ICI by its worldwide subsidiaries. Stip., ¶ 31."

Comment:

Paragraph 30 of the Joint Stipulation states that the "T" form is the "basic," not the "only," financial report submitted to ICI by its subsidiaries.

Dated: March 27, 1986

Respectfully submitted,

JOHN K. VAN DE KAMP
Attorney General of the State of California

/s/ Patricia Streloff

PATRICIA STRELOFF
Deputy Attorney General
Attorneys for all Defendants

APPENDIX 4

BEFORE THE STATE BOARD OF EQUALIZATION OF THE STATE OF CALIFORNIA

In the Matter of the Appeal of FINNIGAN CORPORATION } No. 85A-623-LB

Appearances:

For Appellant: Ronald B. Schrotenboer
Attorney at Law

For Respondent: Paul J. Petrozzi
Counsel

OPINION

This appeal is made pursuant to section 25666[1] of the Revenue and Taxation Code from the action of the Franchise Tax Board on the protest of Finnigan Corporation against proposed assessment of additional franchise tax in the amounts of $18,957 and $14,537 for the income years 1977 and 1978, respectively. Appellant received refunds for 1976 and 1979 and would be entitled to larger refunds for those years if it prevails. The Franchise Tax Board has agreed to make the appropriate adjustments if necessary.

The issue for determination is whether, in computing the sales factor of the apportionment formula, the Franchise Tax Board (FTB) properly applied the "throw back" rule, thereby treating sales by appellant's wholly-owned subsidiary, Disc Instruments (Disc), to customers located outside of California as California sales.[2]

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[1] Unless otherwise specified, all section references are to sections of the Revenue and Taxation Code as is in effect for the income years in issue.

[2] A second issue, whether the Franchise Tax Board properly applied the "throw back" rule to sales made by appellant, itself, in foreign countries, has been conceded by appellant.

Appellant, a California corporation, is engaged in a unitary business that manufactures and sells scientific instruments. Appellant conducts its unitary business through various subsidiaries, including Disc, in California, other states, and foreign countries.

During the appeal years Disc, also a California corporation, manufactured and sold a line of sophisticated scientific instruments somewhat different from those of appellant to customers inside and outside of California. Disc maintained its own sales staff and had its own customers. Disc was not taxable in any of those states outside of California into which it made sales although appellant, itself, was taxable in those states.

In computing the sales factor of the apportionment formula, sales of tangible personal property are ordinarily assigned to the state of destination of the goods (the destination rule). (Rev. & Tax. Code, § 25135, subd. (a).) However, such sales are assigned, or "thrown back," to California if the property is shipped from this state and the "taxpayer is not taxable in the state of the purchaser" (the "throw back" rule). (Rev. & Tax. Code, § 25135, subd. (b).)

In computing the sales factor appellant treated Disc's out-of-state sales as non-California sales and applied the destination rule. In order for the destination rule to apply, it must be shown that the "taxpayer" is actually taxable in the state to which the goods were shipped, or the states to which the goods were shipped had "jurisdiction to subject the taxpayer to a net income tax regardless of whether, in fact, the state does or does not." (Rev. & Tax. Code, § 25122, subd. (b).) The FTB, however, determined that Disc could not show that it was taxable in those states even though appellant, itself, was taxable in those states. Therefore, the FTB concluded that the "throw back" rule was applicable and treated the sales as California sales, thereby including them in the numerator of the sales factor.

The FTB views this case as one simply involving the burden of proof: Appellant agrees that Disc was not actually taxed in any of the states to which sales were made; therefore,

appellant must show that Disc was subject to a net income tax in those states even though no such tax was imposed. Since appellant cannot satisfy its burden of proof by making such a showing, the FTB concludes that it must prevail.

Although appellant makes several arguments in support of its position, we need to consider only one. Appellant argues that the FTB interprets the word "taxpayer" in the "throw back" rule (Rev. & Tax. Code, § 25135, subd. (b)(2)) differently than it does for all other applicable sections of the Uniform Division of Income For Tax Purposes Act (UDITPA). In effect, appellant argues that the FTB applies the "throw back" rule on a separate corporation basis by interpreting the word "taxpayer" in that contact to mean each corporation considered separately, while interpreting "taxpayer" in all either UDITPA provisions to mean all corporations in the unitary group. Appellant's conclusion is that the "throw back" rule should also be applied on a combined group basis.

While we find appellant's argument somewhat overbroad, it is, nevertheless, persuasive.

The FTB's response to appellant's argument is that it is bound to follow the definition given in Revenue and Taxation Code section 23037:

> Taxpayer means any person or bank subject to the tax imposed under [the Bank and Corporation Tax Law].

Section 23037 is one of several definitional statutes which are all prefaced by section 23030 which provides: "*Except where the context otherwise requires*, the definitions given in this chapter [which includes section 23037] govern the construction of this part." (Emphasis added.) When exploring the thrust of the phrase "[e]xcept where the context otherwise requires," it is instructive to consider the FTB's regulations under UDITPA.

Section 25121, subdivision (a)(1), of the FTB's regulations provides that "[t]he word "taxpayer" as used in these regulations is the same as defined in section 23037 and the

regulations thereunder." (Cal. Admin. Code, tit. 18, § 25121, subd. (a)(1).) However, the same regulation contains the following phrase: "Any taxpayer subject to the taxing jurisdiction of this state." (Cal. Admin. Code, tit. 18, § 25121, subd. (d).) This phrase strongly suggests that the word "taxpayer" is used in, at least, two sentences; one in which the "taxpayer" is taxable in California, and another in which the "taxpayer" is not taxable in this state. An analysis of the various sections of UDITPA bears this out. Thus, it is apparent that the FTB's regulations have adopted the gloss of section 23030.

It is apparent that in all UDITPA provisions dealing with formula apportionment except section 25135, the FTB interprets the term "taxpayer" to mean all of the corporations within the combined unitary group. (See, e.g., Rev. & Tax. Code, §§ 25129, 25130, 25131, and 25134; see also § 25120, subd. (a).) Any other interpretation would violate basic unitary theory since only separate corporations taxable by this state would be included within the ambit of the apportionment statutes. (See *Edison California Stores, Inc.* v. *McColgan*, 30 Cal.2d 472 [183 P.2d 16] (1947.) On the other hand, those UDITPA statutes dealing with specific allocation tend to use the term "taxpayer" to mean the specific corporate entity in question. (See, e.g., Rev. & Tax. Code, §§ 25124-25129; see also Rev. & Tax. Code, § 25137 where "taxpayer" is used three times in three lines with two distinct meanings.) Thus, it is apparent that the term "taxpayer" as used in UDITPA is multifaceted.

It, therefore, remains for us to determine how the term is used in Section 25135, subdivision (b)(2). We believe that basic unitary theory requires us to conclude that, as used in section 25135, subdivision (b)(2), "taxpayer" means all corporations within the combined unitary group. To hold otherwise would result in an apportionment formula which produced a different tax effect where the unitary business was conducted by the divisions of a single corporation than where it was conducted by multiple corporations. No difference in principle is discernible in the two situations. The California Supreme Court has told us that as far as unitary theory is concerned the same rule should apply whether the integral

parts of the unitary business are or are not separately incorporated. *(Edison California Stores, Inc.*, v. *McColgan*, supra, 30 Cal.2d at 473, 480.)

Accordingly, since appellant, a member of the unitary group, was taxable in the foreign states at issue, Disc's sales to those states were improperly thrown back to California. Therefore, the determination of the FTB on this issue must be reversed and its action modified.

ORDER

Pursuant to the view expressed in the opinion of the board on file in this proceeding, and good cause appearing therefor,

IT IS HEREBY ORDERED, ADJUDGED AND DECREED, pursuant to section 25667 of the Revenue and Taxation Code, that the action of the Franchise Tax Board on the protest of Finnigan Corporation against proposed assessments of additional franchise tax in the amounts of $18,957 and $14,537 for the income years 1977 and 1978, respectively, be and the same is hereby modified in accordance with this opinion. In all other respects, the action of the Franchise Tax Board is sustained.

Done at Sacramento, Calfornia, this 25th day of August 1988, by the State Board of Equalization, with Board Members Mr. Dronenburg, Mr. Carpenter, Mr. Collis, and Mr. Davies present.

Ernest J. Dronenburg, Jr., Chairman

Paul Carpenter, Member

Conway H. Collis, Member

John Davies*, Member

_____, Member

*For Gray Davis, per Government Code section 7.9.